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3 July 1986

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International Economic & Energy Weekly [redacted] b3

Synopsis

1 **Perspective—The Philippine Economy: Pulling Up on Its Rural Bootstraps** [redacted] b3

President Aquino's economic advisers are weighing a commitment to rural development as the cornerstone of the new government's program for economic recovery. [redacted] b3

3 **The Philippines: Aquino's Critical Challenge—Reviving the Economy** [redacted]

President Aquino recognizes that her political future depends primarily on reviving the troubled economy, and, in some respects, her government is off to a good start. Nevertheless, maintaining the economic recovery beyond 1987—and, in turn, undercutting the Communist insurgency—will require major economic reforms in agriculture, government finance, the banking system, and trade policy. [redacted] b3

9 b1 b3 [redacted]

15 **Lebanon: Financing the Militias** [redacted] b3

Lebanon's abysmal economy is driving much of the once-thriving Lebanese population to the brink of poverty and is impinging on the activities of the militias, which control most of the country. Rival militias are forced to seek funds more aggressively from local and foreign sources—a process that will almost certainly intensify factional struggles and violence. [redacted] b3

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International
Economic & Energy Weekly [redacted] b3

3 July 1986

Perspective

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The Philippine Economy: Pulling Up on Its Rural Bootstraps [redacted] b3

[redacted]

In our view, a good case can be made for the rural strategy on the grounds that traditional development programs will not significantly improve the living standards of the average Filipino. Import-substitution policies of the Marcos government, for example, foisted high costs on manufacturers, discouraged agricultural export production, and created few industrial jobs. Moreover, Aquino's economic planners cannot count on sustaining growth simply by exporting unprocessed agricultural commodities or manufactured goods; commodity prices this year are at their lowest levels relative to those of manufactures since the 1930s, and most economists expect little improvement for at least the next few years. Furthermore, the low cost of Philippine labor is no longer sufficient by itself to ensure the competitiveness of manufactured goods because, for over a decade, new production technologies have lowered labor's share of total manufacturing costs [redacted] b3

Alternatively, by boosting rural output and incomes through improved rural infrastructure, agricultural extension services, and market-oriented pricing policies, the Philippines, we believe, could develop an internal market capable of supporting economic growth while avoiding the inefficiencies of import-substitution policies. A necessary component of this strategy would be an exchange rate depreciation that directly raises incomes for rural exporters and makes it profitable to invest in agribusiness enterprises. We believe the peso's nearly 50-percent devaluation since late 1983, for example, helped boost agricultural output by nearly 5 percent during 1984-85—in contrast to a 10-percent decline in the economy's overall production. [redacted] b3

Aquino's government, nevertheless, faces numerous political hurdles in carrying out a rural-focused development strategy. Urban interest groups—which were responsible for ousting Marcos—are likely to oppose exchange rate, tariff, pricing, and tax policies designed to boost the rural economy if they believe those policies would hurt urban industries or raise consumer prices. Furthermore, Aquino's economic team—comprising businessmen, bankers, and academics with little understanding of small-scale agriculture—may not be sufficiently committed to rural development to overcome lobbying by urban

interest groups. Complicating the picture is the time it takes for rural development to succeed under even the best of circumstances, and Aquino has said publicly that she has to deliver tangible benefits quickly in the countryside. [redacted]

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Manila's projected large budget deficit this year—probably more than 4 percent of national output—will also restrict the scope of the government's rural development effort. A high-impact rural development program requires large outlays for roads, postharvest food storage, irrigation, and a revitalized agriculture extension service. In addition, improving farmers' welfare will require costly improvements in both the civilian and military counterinsurgency programs to increase rural security. [redacted]

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The Philippines: Aquino's Critical Challenge— Reviving the Economy [redacted] b3

President Aquino recognizes that her political future depends primarily on reviving the troubled economy, and, in some respects, her government is off to a good start. If investor confidence continues to firm, the economy could grow by 1.6 percent this year and by almost 6 percent next year, according to our econometric simulations. Nevertheless, maintaining the economic recovery beyond 1987—and, in turn, undercutting the Communist insurgency—will require major economic reforms in agriculture, government finance, the banking system, and trade policy. Conservative-minded advisers, such as Finance Minister Ongpin, will face considerable opposition to these reforms from populists and nationalists in Aquino's Cabinet. [redacted] b3

Aquino's Economic Opportunity

Despite the fact that the Philippine economy has been ravaged over the past decade, Aquino comes to power at an opportune time in the business cycle. [redacted] the economy bottomed out late last year from the recession that began in 1983 and is now probably growing slightly—a development that preliminary Philippine Government estimates of GNP for the first quarter of this year confirm. In addition, inflation is low—prices actually fell in April—interest rates are declining, and foreign exchange reserves have increased by nearly $800 million to $1.7 billion since Aquino took office. [redacted] b3

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Continued economic recovery in the short term depends heavily on private-sector confidence as Manila finds it increasingly difficult to use more traditional fiscal and monetary tools to prime the economy. A $1.9 billion projected budget deficit for this year—primarily the result of preelection spending by Marcos—will, in our view, force Manila to trim spending or raise taxes to reduce the deficit to a manageable level. In addition, the deficit is a major point of contention with the IMF in negotiations for a new standby credit agreement. Finally, export growth will provide little help to the economy; slower demand growth in the United States and Japan and low prices for the Philippines' leading commodity exports—coconuts and sugar—will probably keep overseas sales flat this year. [redacted] b3

For their part, domestic investors are responding enthusiastically to the change in government. Underlining this confidence, stock prices on the relatively small Philippine stock exchange have increased by almost 40 percent since Aquino took office and capital flight, which was rife in the last two years under Marcos, appears to have ended. If domestic business confidence continues to firm and the confidence of foreign investors strengthens, the economy will grow by about 1.6 percent this year and by almost 6 percent in 1987, according to our econometric model. [redacted] b3

On the financial side, an improved foreign payments position over the next two years hinges on foreign creditors agreeing to reschedule principal payments falling due in 1987. Principal payments on the foreign debt are scheduled to jump by more than $1 billion next year because the 1985 rescheduling agreement included only debts maturing through the end of 1986. A rescheduling of both public and private debt will allow Manila to maintain foreign exchange reserves at relatively comfortable levels of $2-3 billion over the next few years with little additional external financing. Moreover, the Philippines' external finances will probably improve this year because of the dramatic

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falls in world oil prices and international interest rates that together will save the government nearly $1 billion in foreign exchange outlays. [redacted] b3

There is considerable downside risk in the outlook, however. Continued business confidence is not assured, and foreign investors are especially cautious. b3 [redacted] they are looking for at least six months of economic and political improvement before risking investments of new money. In particular, Japanese businessmen—[redacted] b1 [redacted] are worried about the strength and longevity of the Aquino government, b3 [redacted] b3

A Reform Agenda: Core Issues

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Agricultural Productivity. Agriculture, which generates more than one-fourth of national output and provides livelihood for 70 percent of the population, was severely damaged under the Marcos government by monopolies, misdirected investment, and an overvalued exchange rate. Freeing agriculture from the control of marketing monopolies is a major first step to increase rural incomes. We estimate, for example, that the lifting in March 1986 of the four-year ban on the export of copra—the oil-bearing meat of the coconut—will increase domestic copra prices by at least 50 percent over the next year as oil mills and exporters compete for domestic copra. In addition, allowing the peso to depreciate further would boost exporters' incomes and help direct investment into more profitable rural ventures, such as food-processing industries.[2] [redacted] b3

[2] Although the Philippine peso has been devalued by 50 percent against the US dollar since 1983, we calculate that, at 20.5 pesos per dollar in May 1986, the exchange rate remains overvalued by as much as 25 percent. [redacted] b3

The Philippines: Balance of Payments, 1981-86

Million US $

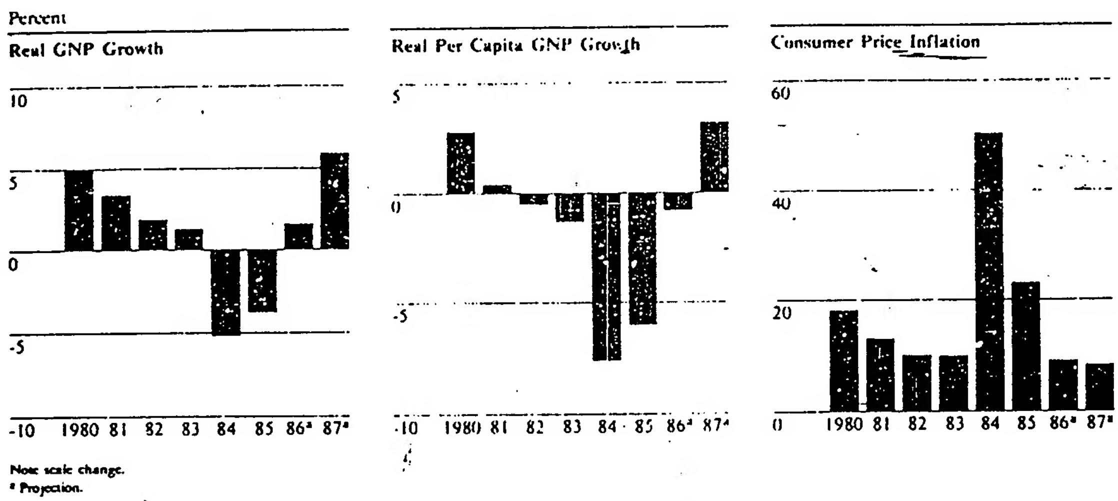
	1981	1982	1983	1984	1985	1986 •
Current account	−2,096	−3,212	−2,751	−1,253	105	661
Trade balance	−2,224	−2,646	−2,485	−679	−486	−305
Merchandise exports	5,772	5,021	5,005	5,391	4,628	4,555
Coconut oil, crude and refined	533	401	516	580	347	350
Sugar, raw and refined	567	416	299	246	169	125
Copper, concentrates	429	312	249	115	84	90
Electronics products	838	1,000	1,053	1,329	1,056	1,100
Garments	616	539	545	603	622	650
Merchandise imports	7,946	7,667	7,490	6,070	5,114	4,860
Crude petroleum	2,381	1,784	1,741	1,472	1,278	1,000
Service exports	2,861	2,983	3,127	2,626	3,284	3,440
Service imports	3,205	4,023	3,865	3,586	3,155	2,940
Interest payments	1,374	1,911	1,929	2,380	2,125	1,990
Private transfers, net	325	322	237	118	140	144
Official transfers, net	147	152	235	268	322	322
Capital account	2,009	2,570	−622	998	1,986	316
Direct investment, net	172	16	105	−6	−7	40
Portfolio investment, net	3	1	7	−3	−4	38
Other long-term capital, net	1,131	1,548	1,044	257	3,052	50
Other short-term capital, net	712	1,281	−1,550	502	−1,728	−62
Errors and omissions	−490	−364	−356	100	540	0
Other	481	88	128	148	133	250
Overall balance	−87	−642	−3,373	−255	2,091	977
Foreign exchange reserves (end of year)	2,066	888	747	662	615	2,400

• Estimated.

b3 [redacted]

The Government Budget. Manila ran annual budget deficits since the mid-1970s, half of which were financed by overseas loans. A major source of the budget problem is inefficiency in the domestic tax system, including a narrow tax base and poor collection. Import duties and export taxes, which account for almost 35 percent of revenues, have been sharply reduced as foreign trade declined over the past few years. At the same time, money-losing government corporations are a major drain on the budget from the spending side, costing Manila almost $1 billion a year in operating subsidies. Narrowing the deficit would reduce the country's reliance on foreign capital and spur domestic investment by freeing savings for private use. Returning ailing corporations to the private sector would slash government expenditures, but, given their weak balance sheets, Manila may find it difficult to find buyers. The government, for example, believes that the private sector is interested in purchasing only five of the 35 companies held under the National Development Corporation—a government holding company. [redacted] b3

The Philippines: Selected Economic Indicators, 1980-87



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Financial System. The Philippine banking system is undercapitalized and has been threatened over the last several years by failing public banks and deteriorating loan portfolios. Banks are stuck with nearly $5 billion in problem loans primarily because they financed the government's acquisition of financially distressed firms, many of which were purchased from political allies of Marcos. [redacted]

Moves to shore up the financial system would include merging some private banks, as well as limiting new lending by government financial institutions and transferring some of their functions to the private sector. A strengthened banking system would, in our view, more effectively channel savings to high-return investment projects and reduce the country's reliance on foreign borrowing by encouraging domestic saving. [redacted] b3

International Competitiveness. [redacted] b1, b3 Philippine industry—operating within an extensive network of tariff and nontariff barriers—has had the lowest export growth among developing countries in East Asia over the last several years. High tariffs have insulated domestic firms from tough import competition and, as a result, have left much of the economy plagued with high-cost, inefficient production. In addition, an overvalued exchange rate—designed to benefit politically active urban consumers under Marcos—discourages exports, encourages imports, and directs investment to enterprises that can only sell to the domestic market. Under pressure from Manila's financial creditors, limited progress was

The Philippines: Key Economic Issues, Political Pressures, and Likely Outcomes, 1986

Issues	Politics	Likely Outcome
Foreign debt	Leftists and nationalists will push hard for radical approach, but Finance Minister Ongpin strongly opposes such moves. He will make this a key fight if necessary.	Radical approach unlikely, particularly if IMF allows more expansionary policy. Will probably follow lead of other LDC debtors in negotiations with commercial banks.
Rural development	Leftists emphasize income redistribution and champion sweeping land reform, subsidized interest rates for farmers, and strict price controls. Ongpin, however, promotes private-sector initiatives and channeling credit to rural areas.	A modest land reform program will begin, support prices for agricultural goods are likely, and new rural lending institutions will be established. Despite considerable rhetoric, however, Manila will be slow to undertake comprehensive rural development.
Agricultural monopolies	Nearly all coalition members favor dismantling the monopolies.	Moves to dismantle the monopolies have begun, including allowing the export of copra.
Government corporations	Ongpin in favor of privatizing numerous government corporations. Nationalists and small businessmen will argue against allowing overseas companies to purchase these firms.	Privatization will probably move ahead but with restrictions on foreign ownership. Biggest problem will be finding domestic buyers for the troubled firms.
Budget deficit	Except for economic technocrats, almost universal opposition to tax reform that would result in higher taxes. Ongpin favors reducing deficit with spending cuts, but populists will push expensive social programs.	Even with the privatization of government corporations, Manila will have a difficult time reducing the deficit without higher taxes. Will be contentious issue in IMF negotiations.
Exchange rate	Ongpin, technocrats, and export-oriented businesses will push for a freely floating rate, which will probably result in a depreciation of the peso as the economy strengthens. Populists in the Cabinet, however, want to avoid the politically costly inflation that would result.	A managed float with slight depreciation.
Labor disputes	Could be an area of severe disagreement among coalition members—particularly between left-leaning Labor Minister Sanchez and the probable hardline approach of Defense Minister Enrile.	A stronger government mediation role is possible. Could also generate considerable political fallout.
Disposing of crony assets	Ongpin favors dumping the assets of Marcos's associates on the free market. Nationalists may argue that the government should retain them, while others—such as Jose Cojuangco and Vice President Laurel—would not object if they received some of the spoils.	If pre-martial-law ownership is clear, assets will probably be returned to original owner with substantial political benefits. Otherwise, most assets will probably be sold on the open market.
Banking system	Ongpin favors free market approach, but most other Cabinet members will oppose reforms if they result in large job losses.	Moderate level of reforms likely. Will help placate foreign creditors.
Foreign trade and investment	Technocrats and trade-oriented businesses favor more open environment, but populists in Cabinet are wary of increased competition. Heavy opposition from small businessmen and nationalists.	Moves to open the economy will be slow and will probably generate extensive public debate.

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made under the Marcos government in areas such as loosening foreign exchange regulations, but most barriers to trade remain [redacted] b3

Looking Ahead

Although most of Aquino's economic advisers—including Finance Minister Ongpin and Trade Minister Concepcion—support economic reform, progress will probably be slow in coming. Many of Aquino's closest advisers would prefer that the new government move in a populist direction, chiefly toward more social spending and continued protection of inefficient domestic industries and employment. Several important political constituencies—consumers, small businessmen, and organized labor—are likely to mount stiff resistance to tax, trade, foreign investment, and financial reforms because, despite the potential long-term benefits, these reforms entail short-term costs. [redacted] b3

If Aquino indulges the populists, the economy could become her biggest liability, particularly because expectations for improvement among Filipinos are so high. Short-term economic recovery and a piecemeal approach to economic reforms, for example, will not be enough to provide the boost in rural living standards needed to undercut the Communist insurgency. Even if the economy grows by an average of 5 percent a year after 1987—a difficult task without major reforms—per capita income could not return to the 1981 peak until 1994. Without an improvement in the distribution of income, the Communists will continue to make political and military inroads in the countryside no matter how well the middle class in Manila is doing. [redacted] b3

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Lebanon: Financing the Militias [redacted] b3

Lebanon's abysmal economy is driving much of the once-thriving Lebanese population to the brink of poverty and is impinging on the activities of the militias, which control most of the country. Rival militias are forced to seek funds more aggressively from local and foreign sources—a process that will almost certainly intensify factional struggles and violence. The militias have become more opportunistic in shifting alliances and patrons in order to survive. The result will be further destruction of what is left of the economy, and fading hope for any reunification. [redacted] b3

Militia Money Woes

All of the major militias have experienced shrinking revenues, especially from sources abroad, and have stepped up illegal activities to raise funds. [redacted] Muslim West Beirut recently suffered a two-week cutoff of petroleum deliveries after transport trucks refused to cross the Green Line because their cargoes were likely to be stolen. [redacted]

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The militias depend on financial support from residents of cities and villages in their respective cantons. The relative poverty of many rural areas, however, is pushing the militia leaders to turn to alternative sources for funds:

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The Christian Lebanese Forces seek money from local merchants and other commercial establishments in East Beirut, levying a special tax on restaurants, petroleum, cinemas, and the Casino du Liban. In addition, the Christian militia controls three illegal ports in the Christian enclave, and leases them to Christian entrepreneurs for large sums. We believe that revenues from these port operations dropped significantly after Syria tightened its border in January to stem illegal imports. [redacted]

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Foreign Support Dwindling

We believe that funding from major supporters, Syria and Iran, as well as Libya, has generally declined over the past two years as the various patrons have suffered economic problems of their own. As a result, the rival militias have sought multiple patrons—often with opposing aims—to finance militia activities and further their own interests. [redacted] b3

Syria gives financial and military support to several allies in Lebanon, including the Shia Amal organization, the Syrian Socialist National Party, the Ba'th Party, and the Lebanese Communist Party. Amal receives the lion's share, and there are reliable reports that Amal is now almost totally

Impact on the Economy

Although the militias ultimately represent a destructive element in the economy, financial support they receive from Iran, Syria, the PLO, and others actually provide a short-term economic boost. Lebanon's only bright spot in 1985 was a foreign payments surplus of $250 million, which is expected to increase in 1986. [redacted] *"unidentified payments" inflows grew by 25 percent last year to $1.6 billion. Although a portion of this came from increased worker remittances as more Lebanese found work abroad, outside financial support for the militias probably accounted for much of the increase. Palestinian money flowed back into Lebanon beginning in early 1985 as expelled PLO fighters returned. The PLO has also substantially increased arms deliveries and financial support since its departure in 1983.* [redacted]

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In addition, the rival militias offer young, uneducated Lebanese men one of the few remaining job opportunities available in Lebanon. Unemployment is near 50 percent, and real annual per capita income has fallen to about $250 from $1,250 in 1975. Militia salaries and the money and goods acquired as "protection fees" from local businessmen appear increasingly attractive to many: [redacted]

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Nonetheless, on balance, militia violence and declining security have devastated the economy. Industrial activity is currently at 40 percent of capacity, and the chances of external financial support are slim. [redacted] *In addition, much of the skilled, professional class has finally opted to leave the country.* [redacted]

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dependent on Syria for military support. [redacted] In fact, Amal leader Nabih Barri has proposed a Shia fundraising conference for Africa in July to attract funds from Lebanese expatriates in Sierra Leone, Ivory Coast, Liberia, and elsewhere. Amal, however, faces increasing competition for Shia African money from other militias, including Hizballah and the Syrian Socialist National Party. [redacted]

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Iran's principal surrogate, Hizballah, is financially dependent on Tehran and is suffering a shortage of funds as the war with Iraq saps Tehran's resources. The Iranians typically funnel support through Damascus, but Tehran also provides funding through representatives in Beirut. Iran's financial support for the militia has fallen behind, and salaries for militiamen are several months in arrears. Hizballah faces the prospect of losing militiamen to rival groups. We believe that Hizballah now regularly receives military aid and large sums of cash from Arafat to help undermine Amal and Syrian interests in Lebanon. [redacted]

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The Druze and their political party, the Progressive Socialist Party (PSP), are better organized than other Lebanese militias and are perhaps the most adept at attracting funds from the region's antagonists:

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Lebanon: Militias and Their Sources of Support, 1986

Militia/Supporters	Comments
Druze	
USSR	Supplies arms, making Druze best-armed militia.
Syria	Transit point for Soviet arms.
Libya	Pays some salaries, allowed to maintain presence.
b1,b3 [redacted]	
PLO	Pays for help infiltrating Fatah fighters through Khaldah.
Christian Lebanese Forces	
Domestic	Illegal ports, taxes, checkpoints.
Expatriates	Collect funds from Christians in Europe, Africa, and United States.
b1,b3 [redacted]	
Amal	
Syria	Military aid and salaries
Expatriates	Collect funds from Shia businessmen in Middle East and West Africa.
Hizballah	
Iran	Principal donor, funnels funds through Embassy in Damascus.
PLO	Pays for arms and for help in infiltrating Fatah fighters.
Libya	Selected payments to individual members.
Syrian Socialist National Party	
Syria	Military aid
Libya	Mainly pays salaries.
Sunnis	
b1,b3 [redacted]	
Libya	Aid to anti-Arafat groups.
PLO	Aid to counter Amal and other pro-Syrian elements.

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- Meanwhile, the Druze port was also used in 1985 for periodic arms deliveries from Libya to major anti-Arafat factions in Lebanon.
- b1 b3 [redacted]
- b1 b3 [redacted]

Outlook

The economic decline in Lebanon will almost certainly increase the militias' dependence on external sources, which will probably lead to even greater outside interference in Lebanon. Foreign players will probably take advantage of Lebanon's economic chaos to buy influence among rival factions. Continued militia violence will further destabilize the country and diminish the prospects for economic recovery and breaking the political stalemate. [redacted] b3

The shortage of money both internally and abroad will intensify factional rivalries and help institutionalize the practice of "guns for hire." Competition for funds will encourage militias to serve several masters, further complicating the Lebanese scene. In addition to robbery and extortion, cash-starved militias may increasingly engage in drug trafficking. Both rival and allied militias will vie more fiercely for turf to compensate for shrinking revenues—a development that will push street fighting to dangerous new levels. [redacted] b3

Finally, the pressures toward cantonization will increase with the decline in Lebanon's security situation. The growing violence will inhibit the human and commercial traffic between cantons. As rival groups seek to establish autonomous economic enclaves, the prospects for political reintegration become less likely [redacted] b3

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Briefs

Energy

Another Inconclusive OPEC Meeting

OPEC adjourned its latest meeting without any formal agreement on production or pricing targets. The members agreed to reconvene in Geneva on 28 July. In the interim, oil ministers will review proposals on individual production quotas with heads of states. The inconclusive meeting probably means that OPEC production will remain high, nonmembers will have little incentive to cut output, and world oil prices will dip below the current average of about $14 per barrel. Oil ministers at least have proposals to take home and this may set the stage for an accord later in the year, when seasonal increases in demand will make agreement easier. Iran indicated some willingness to accept a temporary price target of $17 to $20 per barrel—a concession that could help facilitate a new accord—but substantial differences remain between Tehran and the majority of OPEC members on the issue of production quotas. [redacted] b3

Sudan's Oil Dealings

Sudan appears to have secured sufficient petroleum to meet its needs through September 1986 and hopes to obtain at least an additional year's worth from other donors. In late May, Saudi Arabia agreed to supply crude oil in exchange for Sudanese sorghum. The final shipment from the Saudis arrived in June and is expected to last through July. In addition, Libya has promised to cover Sudan's petroleum needs for August and September 1986 in exchange for $27 million worth of beef. [redacted]

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China Increasing Coal Exports

Beijing is planning to triple its coal exports to 30 million metric tons annually by 1990 to help offset losses of foreign exchange from lower oil prices. China announced on Sunday that its coal exports should reach 10 million tons in 1986, a 32-percent increase over exports in 1985. China has developed new markets for coal in South Korea, the Netherlands, and Turkey. Some of the increase will come from China's share of coal from the Sino-US joint-venture coal mine at Pingshuo, which will open next year. Because of lower international coal prices, however, additional exports this year will offset little of the $2 billion China probably will lose in oil exports. Beijing has the resources to meet its goal for 1990, and, if necessary, it will drop its price for coal to develop new markets. [redacted]

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International Finance

Mozambique Preparing for IMF Negotiations

The Mozambican Government has prepared a package of economic reforms designed to induce a favorable response from an IMF team scheduled to visit Maputo on 7 July, [redacted] The package includes a substantial devaluation, reduced budget deficits, credit restrictions, and liberalized price controls. Mozambique wants an IMF agreement to help it recover from a staggering 20-percent economic contraction in 1985 caused by countrywide insurgent activity. An IMF loan also would round out a two-year effort by Maputo to increase its economic ties to Western institutions and to reduce its reliance on socialist economic programs. Although Mozambique is determined to conclude a deal with the IMF, [redacted] negotiations probably will be drawn out and the effectiveness of new economic reform measures will depend heavily on the course of the insurgency and the willingness of Western countries to increase aid donations. [redacted] b3

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Global and Regional Developments

Bogota Summit of Latin Coffee Producers

The delegates from Latin America's major coffee producers (Brazil, Colombia, Mexico, and Central America) met in Bogota recently to prepare for the September meeting of the International Coffee Agreement in London, where producers and consumers determine world coffee quotas for the next year. In an unprecedented decision, the producers agreed to ~~back joint~~ Brazilian-Colombian efforts to maintain current high prices in the world coffee market, which was recently affected by speculative buying after Brazil's harvest shortfall early this year. Brazilian Coffee Institute President Graciano maintained that he would not permit any reduction in Brazil's quota, despite recent weather-induced crop losses; he backed the Colombian position that quotas should be based, in part, on stocks held by producer countries. Colombia is the only producer that will have sizable stocks on hand next year, and Colombian Federation of Coffee Growers officials believe these would serve to maintain coffee prices at reasonable levels. All delegates urged continued US adherence to the International Coffee Agreement. [redacted]

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Angola Paying Oil to Cuba

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Angola has persuaded Cuba to accept 3.5 million barrels of crude oil over the next six months as compensation for Cuban construction projects in Angola, [redacted] Frustration over what it considered unfairly low prices for Angolan oil on world markets apparently induced Luanda to ask Cuba to accept the oil deal. In early June, for example, Angola's state-owned oil company was able to get only $7.50 a barrel for 200,000 barrels of crude oil delivered to European companies, according to a reliable source. [redacted] At the current world average price, the oil shipments would be worth $50 million, about one-third of Angola's estimated annual bill for nonmilitary services from Cuba. [redacted]

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National Developments

Developed Countries

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Weak Norwegian Austerity Program

The Norwegian parliament's $420 million austerity package falls far short of solving Oslo's fiscal problems because oil tax revenues are expected to decline by at least $2 billion this year and another $3 billion next year. After failing to get a personal income tax increase, the new minority Labor government accepted many proposals from the opposition parties. The resulting package includes spending cuts as well as increased national pension system contributions and higher taxes on gasoline, tobacco, and ~~alcohol~~. The government did not seek a vote of confidence on any of the items, indicating it wants to stay in office for now. Meanwhile, although the opposition parties cooperated to block many Labor proposals, they do not want to contest Labor's hold on power yet. With Norway facing an economic slowdown and the prospect of rising unemployment, the opposition will hope that discontent with the Labor government grows. More intense confrontation on economic issues is likely to occur after parliament resumes in the fall. [redacted] b3

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Iran Searching for Foreign Exchange

Lower oil prices are pushing Tehran to try to collect some of the $2.5 billion tied up in disputes with the United States and France. Iran is seeking to expedite unresolved cases before the Iran-US Claims Tribunal, created in 1981 to settle bilateral commercial disputes. The National Iranian Oil Company may try to reach settlements with US claimants outside the Tribunal in two cases. [redacted] Tehran also has recently intensified efforts to obtain repayment of a $1 billion loan to France by the Shah. Tehran had previously insisted that all unresolved claims—estimated at about 2,000, including several large claims involving US oil companies—be settled individually; it probably will be more willing to expedite claims now, but quick settlements remain unlikely. Iran has about $3 billion in readily accessible foreign exchange reserves but would like to free funds tied up in litigation—about $1 billion—to limit import reductions. [redacted]

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India's Export Incentives

New Delhi is preparing a package of income tax relief measures designed to boost exports. [redacted] The measures are expected to be submitted for parliamentary approval this summer. India's exports declined last year and its trade deficit exceeded $6 billion. India's five-year development plan calls for 6.8-percent average growth in export volume during FY 1986, but this is the first major attempt by the government to stimulate exports. The proposed measures include special tax credits for foreign exchange earnings and a 50-percent tax credit for export profits. [redacted] the export incentives may include subsidies that would violate GATT codes and open India to countervailing duty action by trading partners. [redacted]

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Soviet Grain Imports Tumble

Estimated Soviet grain purchases of almost 31 million metric tons during the marketing year that ended 30 June were at a five-year low and a marked reduction from the record 54 million tons purchased in the 1984/85 marketing year. Improved domestic crop production and lower market grain prices helped cut the hard currency grain import bill by an estimated $3 billion to about $3.5 billion. These savings were partially offset, however, by a more than doubling of soybean imports, a possible reflection of plans to improve the mix of livestock feeds. Heavy Soviet buying of US soybeans—1.5 million tons over the past year—contrasted sharply with Moscow's activity in US wheat markets, where reduced Soviet demand and high US prices limited purchases to only 153,000 tons. Despite some probable small wheat purchases, the overall pace of Soviet grain buying shows little sign of picking up as continued favorable crop production forecasts and hard currency constraints will probably limit grain imports in the near term. [redacted] b3

New Soviet Guidelines for Higher Education

Moscow recently published draft guidelines to make higher education more responsive to requirements for critical technical skills to support the industrial modernization program. The new guidelines call for a system of contractual relationships between higher educational institutions and enterprises—the institutions will supply graduates in needed specialties in return for funding to upgrade educational facilities and equipment. Higher educational institutions are to make their research more relevant to the needs of industry, cut down on the proliferation of specialties, and emphasize a broad general scientific background that will enable students to better adapt to changing technology. Students are to spend more time in independent work and practical training in new "educational-scientific-production complexes" and regional training centers sponsored by enterprises. To address the serious problem of underemployment of skilled labor—currently one-half of college-educated specialists are in jobs that do not utilize their skills—secondary schools are to graduate more midlevel technicians, while standards for admission to higher schools will be raised for engineering and other technical specialties. There will be higher wages for the relatively low-paid engineering profession as well as more pay differentiation according to the quality of work and the complexity of the job. The new program for restructuring higher education is the latest in a series of measures aimed at alleviating the shortage of skilled labor. Success will depend on whether the new system of contract relationships provides enterprises with a real incentive to increase their investment in the educational process as well as on whether the enterprises will have the funds to invest.

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Czechoslovakia Forms First Joint Venture

Czechoslovakia has agreed to form its first joint venture with a Western company in a test of the feasibility of direct foreign investment. The new entity will produce measuring equipment and will involve a modest $2 million investment by the Danish partner Senetec. The Czechoslovaks are also nearing agreement on a large joint venture with the Dutch firm Philips to produce compact disk players, and have been in touch with the Japanese firms Toshiba and JVC. Complicated legal arrangements and a resultant uncertainty over the rights of Western partners have hampered formation of these experimental joint ventures. Reservations by hardline elements in the leadership have also been an inhibiting factor, although increasing Soviet interest in joint ventures may help reassure them. If successful, the experimental joint ventures could give a boost to the Czechoslovak electronics industry--a key sector in leading industrial modernization under Prague's 1986-90 Five-Year Plan—and lead to more extensive joint venture formation in the future. [redacted] b3

China To Increase Nonferrous Metals Exports

The Chinese apparently plan to increase exports of selected nonferrous metals, including tungsten and tin, and use the earnings to purchase technology for China's copper and aluminum industries. Chinese purchases of copper and aluminum are a major drain on Beijing's foreign currency reserves; we estimate that imports of these metals reached nearly $1 billion in 1985. China—with small copper reserves—wants to upgrade domestic production to reduce imports. On the other hand, China's rich bauxite deposits may support enough growth in its aluminum industry to make China an exporter by 1990.

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Chinese Plan Dairy Expansion

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China plans to increase its dairy herd from the current 1.3 million head to 8 million head by the year 2000. The Chinese stated that they were focusing on US breeding stock, and have already purchased several hundred US dairy cattle this year. However, China is purchasing even more dairy cattle from Western Europe, and, [redacted], will continue to do so because of EC subsidies for medium-quality breeding cattle. [redacted] b3 b3 [redacted] the Chinese plan to purchase some high-quality dairy cattle from US breeders to improve herd quality, but would purchase more if prices were more competitive with EC cattle. [redacted] b3

Beijing Reaffirms Emphasis on Science and Technology

Ranking government and party officials reassured scientists of their support for S&T reform at the Chinese Association for Science and Technology (CAST) Congress last week. Hu Qili, member of the Politburo and Central Committee Secretariat, urged more support for S&T management reforms to increase the contribution of S&T to economic development. Furthermore, Hu endorsed the concept of greater academic freedom, a key concern among China's scientific community; the assembly later ~~adopted~~ this principle as part of the CAST constitution. Song Jian, State Councilor and Minister of the State Science and Technology Commission, also noted that laws are being drafted to protect scientists from outside interference. Although many scientists have reacted enthusiastically to incentives to work closely with industry, for others there is confusion over what is permitted, concern that political support for the changes would lessen, and fear that their own power or prestige would decrease. Beijing probably hopes that the high-level show of support, aimed at an organization with 6.7 million members, will prompt the footdraggers to more speedily carry out the reforms. [redacted] b3

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